Abstract

In 2020, affected by the outbreak of the coronavirus disease 2019 (COVID-19) pandemic, the global economy fell into recession and financial vulnerability continued to build up. Nevertheless, thanks to the government's well-developed support measures for addressing the pandemic, the domestic economy grew moderately along with mild inflation. The performance of the corporate and household sectors also remained sound. In addition, as the real estate market showed signs of heating up, the government implemented several measures to ensure the soundness of the market. Against this backdrop, financial institutions were in good health and financial markets kept operating smoothly. On the whole, the financial system remained stable; however, the subsequent impacts of global and domestic pandemic developments on Taiwan's economic and financial conditions warrant close attention.

The impacts on international and domestic macro environments arising from the COVID-19 pandemic took divergent paths

With regard to the global economy, while the COVID-19 pandemic caused a severe recession in 2020, central banks in major economies have adopted more accommodative monetary policies and taken further fiscal stimulus so as to mitigate downside risks to the economy. From 2021 onwards, thanks to massive fiscal and monetary policies adopted by major economies and expanded vaccinations, IHS Markit anticipates that the global economy will regain momentum. Nevertheless, the International Monetary Fund (IMF) warned that the most noteworthy uncertainty surrounding the global economy still derives from uncertainties around the pace of vaccine rollout and efficacy. When it comes to financial markets, extremely easy financial conditions have elevated nonfinancial private sector debt. Moreover, a stark divide between financial markets and economic conditions has fueled financial vulnerabilities. Once a quicker Fed normalization triggers a sharp rise in interest rates, it could induce a correction in financial markets and, in turn, hamper market confidence and endanger financial stability.

Regarding the domestic economy, as Taiwan was less impacted by the COVID-19 pandemic, the economy grew mildly and domestic prices rose moderately in 2020. External debt expanded slightly but foreign exchange (FX) reserves remained ample, indicating that external debt-

servicing capacity stayed strong. Fiscal deficits reached record highs because of measures launched by the government to mitigate the impact of the pandemic. Government debt increased yet still stayed within a manageable level. Benefitting from the stellar performance of the electronics industry, the profitability of Taiwan Stock Exchange (TWSE) listed and Over-the-counter (OTC) listed companies ascended remarkably. Although household borrowing expanded, the household sector continued to have a high net worth and satisfactory credit quality. Real estate market trading volume and housing prices both surged, while the mortgage burden escalated. To curb speculation in housing market transactions, the government initiated the Healthy Real Estate Market Plan. In response, the Bank also revised targeted macroprudential measures governing real estate loans twice. With the evolution of the pandemic globally and domestically, its impact on the debt-servicing capacity of the corporate and household sectors warrants close attention.

Financial markets, institutions, and infrastructures operated smoothly

Bill and bond issuance in the primary market reached a record high in 2020, while their trading volume in the secondary market took divergent directions. The outright turnover rate of bonds initially rose but turned to stay at a low level thereafter. Stock prices fell back after reaching historical highs, coupled with amplifying volatility. FX markets remained dynamically stable. The profitability of domestic banks decreased in 2020. However, their capital levels increased with satisfactory liquidity, and asset quality remained sound. Life insurance companies exhibited a sharp increase in profitability and a rebound in their capital levels but were exposed to higher equity risk and interest rate risk. Bills finance companies showed significant expansion in profits, although liquidity risks remained high.

Domestic systemically important payment systems functioned in an orderly manner and have not been affected by the COVID-19 pandemic. The Bank also launched the second phase program on a general purpose central bank digital currency (CBDC) in response to digital innovations and relaxed some restrictions for banks engaging in FX business. Meanwhile, the Financial Supervisory Commission (FSC) continued putting forward several policy measures such as green finance and open banking. Furthermore, the FSC revised regulations governing capital requirements of real estate exposures in accordance with international standards and launched a new wealth management scheme underpinned by the enhancement of relevant financial supervision.

The Bank and the FSC took measures to promote financial stability, and the government's economic relief measures showed to be effective

To mitigate the impact of the COVID-19 pandemic on the domestic economy and employment, the Bank cut policy rates in March 2020 and then launched a special accommodation facility to support bank credit to small and medium-sized enterprises (SMEs). The Bank also implemented open market operations for the purpose of adjusting funds in the banking system so as to keep ample liquidity in financial markets. Besides this, the Bank adjusted targeted macroprudential measures twice to attain efficient allocation of banks' credit resources as well as adopting flexible FX policies to safeguard the dynamic stability of the NT dollar exchange rate. Meanwhile, the FSC took timely and flexible measures to respond to the impact of the pandemic on financial markets and required financial institutions to conduct stress tests to assess their ability to weather the impact of the pandemic. Moreover, the FSC strengthened risk management of financial institutions on real estate loans and reinforced the risk bearing capacity of insurance companies to promote financial stability. A number of economic relief measures launched by the Taiwanese government in 2020 effectively mitigated the adverse impact of the pandemic on the domestic macro economy and financial system. In light of recent evolution of the domestic pandemic situation, the aforementioned relief measures have been extended and expanded.

The Bank will continually take measures to promote financial stability as needed

Despite the impact of the pandemic, Taiwan's financial system remained stable in 2020. In the future, the Bank will continually adopt appropriate monetary, credit, and foreign exchange policies. Meanwhile, the FSC will continue to revamp financial regulations and enhance financial supervisory measures in the hope of facilitating sound operations of financial institutions and promoting financial stability. However, considering that international economic and financial developments are still surrounded by many uncertainties and the domestic pandemic has not yet eased, the Bank will continue to pay close attention to the impacts of relevant subsequent developments on domestic economic and financial conditions so as to take appropriate response measures in a timely manner to promote financial stability.